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Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

The Federal Reserve . . .

One popular Wall Street diversion from the midwinter doldrums is speculation regarding the future course of monetary policy. According to some analysts, the lethargic pace of real gross national product growth in the fourth quarter of last year, and the widespread belief that the current quarter may not be much better, will soon justify another, overt Federal Reserve easing move in the not-too-distant future.

Others, however, see the situation quite differently. They view the recent string of somewhat brighter economic statistics, rising commodities prices, stronger bank loan demand and the vulnerable state of the dollar as justifying not only a postponement of more ease, but perhaps, even a modest turn toward restraint. In fact, a few believe that this may have already occurred, and cite as evidence a Federal funds rate persistently hovering above six percent in particular, and rising short-term interest rates in general.

This debate provided the backdrop for the Fed's policy-setting Federal Open Market Committee (FOMC) meeting this week. As usual, the health of the economy was the focus of discussion—and, as usual, uncertainty abounded. For depending upon the prognosticator, the pace of business is either about to: accelerate, if the index of leading economic indicators and January's sharp employment gains are to be believed: move sideways, with growth flattening in the current quarter in response to the tax-reform induced shifting of spending from this year to last, or; contract, as consumers scale back spending as a result of hefty debt burdens and modest incomes growth. According to the latter view, the nearly six percent month-over-month decline in January retail sales is a harbinger of things to come. Whoever is right remains to be seen, but in light of such an array of views, the appropriate stance of monetary policy ranges all the way from more ease to modest restraint.

. . . May No Longer Be . . .

For the policymaker who has to sift through all this, there are probably sufficient elements of truth in all three views to produce something of a policy standoff. Looking at the economy alone, there are few compelling reasons to alter the Fed's current policy stance either way. Take, for example, the case for easing. Despite a lackluster 1.7 percent fourth quarter real GNP growth rate, the quarter ended on a strong note with employment, factory orders and industrial production all posting good-sized gains. What is more, some of this strength spilled over into the current quarter, at least according to the National Association of Purchasing Management, whose members reported a strong pickup in business activity in January. These developments suggest a diminished need for monetary stimulus.

TUESDAY SPOT PRICE INDEX – RAW INDUSTRIALS
(1967=100)

Source: Commodity Research Bureau

On the other hand, it is difficult to make a case for outright restraint. Not only do numerous soft spots still exist economy-wide, but even some of the more upbeat economic statistics released in recent weeks may overestimate the economy's current buoyancy. The sizable December gain in the index of leading economic indicators partially reflected a scramble by California builders to secure permits before a fee increase; January's hefty employment gain was ballooned to some extent by the inability of seasonal adjustment factors to compensate fully for the fact that the usual post-holiday layoffs in retail trade did not materialize this year. What is more, such upcoming statistics as housing starts and industrial production are likely to paint a picture of an economy growing at only a modest clip. With so many uncertainties surrounding the economy's health, an overt tightening of the credit reins and a sustained rise in interest rates would appear to be unwarranted.

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. . . Pushing Interest Rates Lower

However, while the economy may have produced a policy debate standoff, this was not the only, or perhaps even most important thing, on the minds of the FOMC. The issue of the downside vulnerability of the dollar in the foreign exchange markets, and its implications for both the rate of inflation and the appetite of foreign investors for U.S. dollar-denominated Treasury securities, has almost certainly moved to center stage in the Fed's policy deliberations in recent weeks. This is because the dollar's better than five percent drop against the German mark and three percent decline against the Japanese yen since the turn of the year alone not only raises the specter of a dollar "free fall", but will also serve to push already escalating import prices even higher. Since this comes on top of firming oil prices, and rapidly rising raw industrial commodities prices, the Fed may soon begin to find its policy flexibility hampered by a deteriorating price outlook, as inflation concerns again become a major headache (see chart on page 1).

Limited monetary restraint and higher short-term interest rates might be considered something of a preemptive strike. By helping to shore up the dollar in the

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits of $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/28/87)	153,676	– 2,448	– 12,696
New York City (2/4/87)	36,016	+ 331	– 870
Commercial Paper (2/4/87)	333,281	– 1,248	+ 37,264

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/28/87)	281,959	+ 489	+24,541
New York City (2/4/87)	66,310	+ 367	+ 8,686

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/28/87)	792,722	+ 2,416	+72,283
New York City (2/4/87)	173,542	– 5,255	+17,911

Financial Markets

	Friday 2/13/87	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.80%	– .01	– 1.43
180-Day Bills†	5.85	– .05	– 1.61
Longest Bills†	6.02	+ .11	– 1.58
Recent Issues:			
61/8S 1/31/89	6.38	+ .03	
61/2S 2/15/90 (When Issued)	6.56	NA	
71/4S 11/15/96	7.25	+ .09	
71/2S 11/15/16	7.56	+ .10	
Municipals:			
Bond Buyer–20 Bond Index* (2/12/87)	6.67%	+ .10	– .95
Blue List Total ($ Million)	$1,889	+ $ 217	+$ 514
30-Day Visible Supply ($ Million)	$2,093	– $ 323	+$1,413
Total	$3,982	– $ 106	+$1,927
Corporates:			
Moody's Aa Composite (2/12/87)	8.91%	+ .03	– 1.38
30-Day Visible Supply ($ Million)	$2,307	+ $1,430	+$1,257
Stocks:			
Dow-Jones Averages:			
Industrials	2,183.35	+ 25.31	+518.90
Transportation	922.36	+ 47.48	+149.45
Utilities	220.92	– 3.80	+ 40.27
65 Stocks	837.89	+ 15.72	+175.89
N.Y.S.E. Composite Index	159.56	+ 3.45	+ 32.91
N.Y.S.E. Avg. Daily Vol. for Week (000's)	174,104	– 33,636	+33,994

*46% Taxable equivalent 12.35%. † Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 2/13/87	Week Ago
Overnight	5.94%	5.88%
1 month	6.25	6.06
3 month	6.38	6.13
6 month	6.31	6.13
1 year	6.38	6.19
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	7.13%	7.13%
Long Term (7 to 15 yrs.)	7.93	7.93

FOREIGN EXCHANGE SPOT RATES

New York Opening (2/13/87)	U.S. $ Equivalent	Currency Per U.S. $
Canada	.7438	1.3445
France	.1639	6.1030
Germany	.5467	1.8290
Italy	.0007680	1302.00
Japan	.006510	153.62
Mexico	.0009909	1009.15
Switzerland	.6466	1.5465
U.K.	1.5192	.6582

MH TRADE-WEIGHTED DOLLAR* (2/13/87)	Change Since Week Ago	Change Since 2/27/85
	+0.3%	–6.2%

*Adjusted for Inflation

foreign exchange markets, it would tend to dampen import price increases and might also contain any erosion in foreign investor interest in holding U.S. dollar debt securities, especially Treasury issues. It may not have been purely coincidental that interest rates firmed prior to the Treasury's recent $29 billion refunding operation; with the yield spread widening between U.S. and foreign (especially Japanese) government securities, the attractiveness of Treasury securities to foreign buyers was certainly enhanced. Which brings us to the question: Has the rise in short-term interest rates been a reflection of such factors as hefty Treasury cash balances and rising bank loan demand, or something else—the "else", of course, being the widely speculated snugging of monetary policy?

From this vantage point, the jury is still out. But looking at several of the factors which usually influence Fed policy—the economy, inflation rate prospects and foreign exchange market trends—one may not be blamed for concluding that with few compelling reasons to nudge interest rates lower, and several good reasons to do the opposite, the Fed, at the very least, appears to have looked the other way as interest rates moved higher. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 2/11/87	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	202.457	– 6.585	+21.973
Loans to Depository Inst.	.401	– .047	– .195
Float	.532	– .401	– .599
Total Reserve Bank Credit	221.312	– 6.986	+23.235
Treasury Deposits with Federal Reserve Banks	3.832	– 9.063	– 3.022
Currency in Circulation	206.440	+ .776	+15.166
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	166.675	+ .867	+38.444
	2/11/87		
Member Bank Reserves:			
Total Reserves Held	56.296	– .458	+10.451
Excess (Deficiency)	1.387	+ .168	+ .200
Net Free Reserves	1.227	+ .470	+ .222
		% Change Since	
Monetary Aggregates †		**3 Months' Ago***	**Year Ago**
M1 (2/2/87)	736.9	+ 18.1‡	+ 17.1‡
M2 (January '87)	2,819.0	+ 8.5	+ 9.5
M3 (January '87)	3,511.5	+ 8.0	+ 8.8
Domestic Nonfinancial Debt (3rd Q'86)	7,410.3	+ 11.4	+ 13.5

†Seasonally adjusted.

*Seasonally adjusted annual rate.
‡Four-week moving average.

New York Money Market

Offering Rates 2/13/87	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	5.64%	5.66%	5.67%
* Federal Agencies	5.87	5.85	5.85
* Municipal Notes—High Grade (46% Taxable Equivalent)	6.94	6.85	7.41
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	6.15	6.15	6.25

‡Finance Company Paper—Prime

5- 14 days	6.13%
15- 29 days	6.15
30- 59 days	6.18
60- 89 days	6.15
90-179 days	6.10
180-239 days	6.00
240-270 days	6.00

‡* Bankers' Acceptances

Mar.	6.10%
Apr.	6.07
May	6.00
Jun.	5.96
Jul.	5.93
Aug.	5.92

‡Industrial Paper—Prime

30- 89 days	6.17%
90-120 days	6.08

†Federal Funds Effective Rate 6.10%

‡Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'86	$ 4,268	$ 4,231	$ 4,088
Gross National Product (1982 Dollars)*	4th Q'86	$ 3,702	$ 3,686	$ 3,622
Percent Change, Annual Rate	4th Q'86	1.7	2.8	2.1
Change in Consumer Prices*	Dec '86	2.4%	3.6%	4.8%
Change in Producer Prices*	Jan '87n	7.2%	– 1.2%r	– 8.4%r
Civilian Employment (Thousands of Persons)†	Jan '87n	111,011	110,637r	108,892
Unemployment as % of Civilian Labor Force†	Jan '87n	6.7%	6.7%	6.8%
Personal Income*	Dec '86	$ 3,555	$ 3,527	$ 3,418
Leading Indicators Composite Index (1967=100)†	Dec '86n	186.1	182.2r	173.6
Industrial Production Index (1977=100) †	Jan '87n	126.9	126.4r	126.2
Net Change in Consumer Installment Credit †	Dec '86n	$ 0.11	$ 3.28r	$ 6.48
U.S. Merchandise Trade Balance	Dec '86	–$ 10.66	–$ 15.44	–$ 14.22
Plant and Equipment Expenditures*	1st Q'87	$386.82(a)	$394.34(a)	$377.94
Private Housing Starts (Thousands of Units)*	Dec '86	1,802	1,585	1,882
New Construction Expenditures*	Dec '86n	$ 376.0	$ 377.9r	$ 365.5
Total Business Inventories †	Dec '86n	$ 587.2	$ 590.1r	$ 583.2r
Total Business Sales †	Dec '86n	$ 448.3	$ 435.9r	$ 431.8r

*Seasonally adjusted annual rate. Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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